that provide expertise and network facilities for use in entering the local services market.

These competitors have substantial name recognition in the telecommunications marketplace and existing customer relationships which are easily leveraged into new exchange and exchange access business. They also have significant facilities in place, particularly switches.[23] They are thus uniquely positioned to use unbundled elements and other available resources to enter the market rapidly. The availability of network elements provides all the capacity any competitor needs to enter the market, creating an effective check on an ILEC's ability to maintain above-market rates for interstate access services. In sum, if GTE's access rates are too high, a competitor can simply enter the market by purchasing network elements at low rates and combining them with its own facilities.

B. Regulation Of ILEC Prices And Rate Structures Artificially And Improperly Handicaps ILECs' Ability To Compete.

No regulations constrain new entrants' ability to target profitable markets and customers. These entrants do not have carrier-of-last-resort obligations and are not required to obtain approval for facility construction. This flexibility permits them to target their service offerings to the most profitable customers in the least-cost geographic areas and to exit a market if providing service is no longer profitable.[24]

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[23] *See* Fulp Eighth Circuit Affidavit.

[24] *See* Communications Daily, January 28, 1997, at 7 (reporting that AT&T is targeting a limited class of business customers with its local exchange service offering).

New entrants are also free to raise and lower prices when market circumstances warrant and to customize service packages and prices to meet individual customers' needs. The FCC has already announced that CLECs are nondominant.[25] CLECs may therefore file tariffs on one-day's notice without any cost support, and their filings, including rate structure and price levels, are presumed lawful.[26] Notably, virtually every one of the ILECs' potential competitors is classified as nondominant exchange access providers, and each of these carriers may raise and lower prices without meaningful public notice or an opportunity for protest before regulatory bodies. Moreover, CLECs may offer volume and term discounts and differential pricing depending on geographic locations, and may also enter into customized contracts and make tailored offerings in response to requests for proposal. And, of course, these entities enjoy a substantial and unwarranted competitive advantage by virtue of the fact that they can purchase unbundled network elements at below-cost prices.

In marked contrast, ILECs have virtually no flexibility to respond to new entrant pricing and service offerings.[27] Although it has continuously quoted the 1996 Act's legislative history indicating that Congress wanted competition to replace regulation as

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[25] Tariff Filing Requirements for Nondominant Common Carriers, CC Docket No. 93-36, 8 FCC Rcd 6752, 6754 (1993), *vacated on other grounds*, Southwestern Bell Corp. v. FCC, 43 F.3d 1515 (D.C. Cir. 1995).

[26] Tariff Filing Requirements for Nondominant Common Carriers, CC Docket No. 93-36, 10 FCC Rcd 13,653 (1995).

[27] ILECs' hands are tied even though they are forced to subsidize their competitor's entry through bargain-basement unbundled element pricing. *See* GTE Opposition and Comments to Petitions for Reconsideration at 5-6, in CC Docket No. 96-98, Phase I (filed Oct. 31, 1996).

the preferred method of keeping prices reasonable,[28] the FCC has yet to fulfill that mandate. Instead, the FCC has embarked on a path of creating a skewed market environment where non-ILEC players receive complete freedom to compete and may use unbundled elements priced below cost, while ILECs remain handcuffed and are subject to new and more extensive regulations than in the past. Although this surely will transfer customers and money from ILEC shareholders to new entrants, it will not produce meaningful competition that will benefit consumers. The FCC must, in this and other proceedings, create a balanced competitive landscape by permitting non-ILECs and ILECs alike to price services according to marketplace principles, rather than outdated and overly intrusive regulations. In particular, it is essential that prices for unbundled network elements (to the extent the Eighth Circuit's decision gives the FCC any role in pricing) be set at compensatory levels in order to avoid establishing a price below market levels for access charges.

III. GTE AGREES THAT RATIONAL ACCESS CHARGE RATE STRUCTURES ARE A NECESSARY STEP IN THE NEW PROCOMPETITIVE ERA. (*NPRM*, ¶¶ 41-49, 55-139)

The ability of IXCs to bypass access charges compels significant access charge reform immediately. If the current regime is left in place, many IXCs will have uneconomic incentives to purchase access services from other access providers such as MFS or Teleport. This incentive arises because ILECs are forced to price

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[28] *See, e.g., First Interconnection Order*, ¶¶ 1,3; Policy and Rules Concerning the Interstate, Interexchange Marketplace, CC Docket No. 96-61, ¶ 1 (rel. Oct. 31, 1996), *pet. for rev. pending*.

competitive retail services at significantly higher levels either generally or, due to rate averaging requirements, in specific geographic areas. Pricing distortions created by the access charge rules and arbitrarily low pricing of unbundled network elements also create perverse incentives in other respects. For example, these entities will elect to purchase unbundled elements rather than building their own local and access facilities in areas where facilities-based entry is economically viable. Conversely, they may well build their own facilities where doing so would not be rational but for regulations that prevent ILECs from charging cost-based rates. In either event, competition will be distorted, consumers will be harmed, and ILECs will be deprived of substantial access revenues while still bearing responsibility to provide universal service at affordable rates.

A. The Current Access Charge Rules Create Irrational Pricing.

If the Commission hopes to accomplish its overarching goal in this proceeding of promulgating "access charge rate structures that a competitive market for access services would produce,"[29] it must address the irrational pricing and hidden subsidies inherent in the current system and provide freedom to price to meet competitive pressures. It is only after prices are allowed to reach market levels and this interlocking system of subsidies is dismantled that full and fair competition can blossom for access services.

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[29] *NPRM,* ¶ 13.

Perhaps the most egregious example of irrational pricing and hidden subsidies is the current method of loop cost recovery. Because the carrier common line ("CCL") charge is a usage-based fee that recovers non-usage (non traffic-sensitive) costs, high-volume users subsidize low-volume users, creating an incentive for uneconomic bypass. The current access charge system contains many other examples of irrational pricing and hidden subsidies, including the following:

- Information service providers ("ISPs"), such as Internet access or data retrieval service providers, have been exempted from paying access charges,[30] forcing other users of the network to subsidize their usage.[31]

- The local switching charge recovers the NTS costs of switch ports on a per-minute basis. This cost-revenue misalignment will continue to worsen in the future as digital technologies increase the amount of NTS switching costs. There are other significant central office costs that are more a function of lines served than usage, but that are allocated to the interstate jurisdiction based on usage factors.

- Averaged rates throughout large study areas also produce inefficient pricing, which allows other access providers to siphon away the ILECs' lower-cost customers by pricing just below the averaged rate that FCC regulations require the ILEC to charge.

- Loop costs generally are over-recovered from multi-line business customers, that, in most instances, are already fully paying for their loop costs through intrastate rates and the SLC.

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[30] *See* Amendments of Part 69 of the Commission's Rules Relating to the Creation of Access Charge Subelements for Open Network Architecture, 6 FCC Rcd 4524, 4534-4535 (1991).

[31] GTE has consistently taken the position that all users of the network, including ISPs, should be responsible for paying their own way in a system based on efficient pricing and cost recovery principles. Access reform should provide ILECs with the ability to assess access charges equitably on all access service users, including ISPs. GTE urges the Commission to act expeditiously in resolving this matter as the network congestion caused by ISPs as a result of flat-rated pricing threatens network reliability and cannot be ignored.

- Finally, under the current rate structure, access services that utilize newer technologies may be overpriced. For example, the per-line SLC, because it is currently assessed against derived channels,[32] overprices lines used to provide "multiplexed" services, such as integrated services digital network ("ISDN"), which use a single line to provide the equivalent of multiple services.[33]

B. The Current Access Charge Rules Seriously Damage Consumers And Competition.

Irrational telecommunications pricing harms consumers and competition whether prices are above or below competitive levels. Thus, in order to allow consumers to choose the optimum mix of telecommunications services, and create a regulatory atmosphere that encourages vigorous competition, the Commission should — to the greatest extent practical — allow the market to set the price of access services.

If prices are too high, consumer welfare will be harmed because consumption is below optimal levels and customers pay too much for service. Conversely, if prices are set below market levels, customers will consume excess service, waste resources and drive suppliers from the market. In either case, pricing structures that mask the true cost of providing services send incorrect price signals to consumers, leading to inefficient decisions and higher total costs. For example, recovering a portion of local

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[32] A derived channel is the conceptual portion of a broadband facility necessary to deliver the equivalent of one channel of service. *See* Section IV.A.4, *infra*.

[33] *See* NYNEX Telephone Companies Revisions to Tariff FCC No. 1, 7 FCC Rcd 7938 (Com. Car. Bur. 1992). Since that time, the FCC has begun a proceeding to reform this anomalous pricing scheme for ISDN service, but has not clearly signaled whether it would actually adopt reforms. End User Line Charges, CC Docket No. 95-72, 10 FCC Rcd 8565 (1995). These same issues have been raised in the instant *NPRM* without resolution of the prior proceeding.

loop costs from IXCs through the CCL, rather than directly from end users through a SLC, disguises from consumers the true costs of both local and interexchange service. As a result, they purchase less long distance service than they would if rates reflected market realities because long distance services bear more costs than they should.

Regulatory decisions that mandate pricing in excess of market levels can prevent ILECs from effectively competing with new entrants. For example, if regulators require ILECs, but not their competitors, to charge a full SLC for each derived channel for ISDN services, the ILEC will lose considerable ISDN business as soon as a competitor enters the market, solely because of unwarranted regulatory policies.

Pricing services above efficient levels also can harm new entrants. Where a competitor is "misled" into entering a market by an incumbent's prices mandated by regulation at a level substantially above costs, that entry is inefficient. Since the incumbent firm will be unable to maintain inefficiently high prices over the long run, its prices eventually will decline to more cost-based levels. The new entrant will then lose part of its investment as the ILEC's price falls to more efficient levels. As a consequence, new entrants often protest loudly to regulators to force the incumbent to maintain higher prices.

Other problems arise if regulators require ILECs to price service below cost (as effectively occurs when geographic rate averaging is mandated). This practice deters competitive entry because the ILEC may be underpricing any new entrant that sets its rates based on real-world costs. If the new entrant cannot expect to recover its costs, including its cost of capital, it will have a disincentive to enter the market.

Finally, irrational pricing leads to arbitrage, which occurs when a product is purchased in one market and resold in another to gain the advantage of a price discrepancy between the two markets. Arbitrage is efficient only when all sellers are free to price at market rates. In that event, price discrepancies that are not due to market forces will naturally be eliminated. Arbitrage is inefficient, however, if one or more sellers — in this case, the ILECs — cannot adjust prices to eliminate a price discrepancy. As a consequence, arbitrageurs get a "free ride," and the price-constrained competitor is financially harmed.

C. Rates Set at the FCC's Method of TSLRIC/TELRIC Pricing Are Irrational.

The Commission has increasingly begun to require ILECs to set prices at total service LRIC ("TSLRIC"), and its unbundled network element variant TELRIC. These decisions are bad economics, bad accounting, and bad law.

TSLRIC and TELRIC, are not pricing principles, but rather are costing principles. GTE has consistently argued that TSLRIC/TELRIC are only appropriate in making a predation analysis, not in setting a price ceiling.[34] In any event, they certainly have nothing to do with market prices, despite the FCC's assertions to the contrary. In a mature industry such as telecommunications, pricing is determined by taking into account a number of relevant factors such as existing costs, technology, product

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[34] *See* Comments of GTE at 59-63, CC Docket No. 96-98 (filed May 16, 1996). Reply Comments of GTE at 31-33, CC Docket No. 96-98 (file May 30, 1996).

differentiation, transactions costs and demand elasticities.[35] A hypothetical government concept simply cannot determine the market price better than the market itself can.

These pricing methodologies as defined by the FCC, fail to recover economic costs, even on a going forward basis, because there is an insufficient contribution to joint and common and other actual costs[36] and embedded costs[37] are not included in the calculus.[38] It has been well documented that a multi-product firm must be able to recoup its total costs, or it will go out of business.[39]

Because this type of theoretical pricing does not cover an ILECs' costs, it leads to an unconstitutional taking whether used to price unbundled network elements, to determine the amount of universal service funding, or to set the level of access charges.[40] Such pricing also leads to unjust and unreasonable rates in violation of

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35 *See* Richard Schmalensee & William E. Taylor, "Economic Aspects of Access Reform," attached to USTA's comments ("Schmalensee & Taylor").

36 *See* Schmalensee & Taylor. Other actual costs are not recovered because the FCC has relied on the use of hypothetical cost models that make irrational assumptions about efficient networks and, hence, do not take into account actual ILEC costs that have been prudently incurred. *See* GTE Opposition and Comments in CC Docket No. 96-98.

37 *See* Affidavit of J. Gregory Sidak & Daniel F. Spulber, attached to USTA's comments ("Sidak & Spulber").

38 Compounding the cost recovery problem, numerous states have employed cost methodologies that do not even produce TELRIC rates as defined in the FCC's rules.

39 *See* Schmalensee & Taylor.

40 *See* Section VI.A., *infra*.

Section 201(b) of the Communications Act.[41] Therefore, the FCC should turn back from this disastrous regulatory course.

D. The Rational Access Charge Structure Must Allow Market Forces To Determine Access Charges To The Greatest Extent Possible.

In short, the current access charge regime, as well as other Commission pricing rules, need a complete overhaul. As the Commission correctly concludes, "several provisions in Part 69 of [its] rules compel incumbent LECs to impose charges for access services in a manner that does not accurately reflect the way those LECs incur the costs of providing those services."[42] The result is a flawed rate structure that "do[es] not send accurate pricing signals to customers, and consequently, encourage[s] inefficient use of telecommunications services."[43] Moreover, as the Commission further explains, "inaccurate pricing signals encourage uneconomic bypass of incumbent LEC facilities and could very well skew or limit the development of competition in the markets for telecommunications services."[44] Finally, it is consistent with the 1996 Act to eliminate or make explicit what previously have been implicit subsidies.[45]

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41 *Id.*, VI.B.

42 *NPRM,* ¶ 55.

43 *Id.*

44 *Id.*

45 47 U.S.C. § 254(e). The Senate Report uses access charges as an illustration of an existing implicit subsidy mechanism. S. Rep. No. 23, 104th Congress, 1st Sess., at 4, 30 (1995).

A rational access charge structure must include the following three elements. First, ILECs must be permitted to recover all costs assigned to the interstate jurisdiction. Second, significant deregulation must be implemented immediately so that ILECs can set efficient prices and compete on a level playing field. Third, if the Commission determines that costs currently assigned to the interstate jurisdiction no longer should be recovered through access charges, it must convene a Federal-State Joint Board to change jurisdictional allocations and must allow recovery of those costs in the interim through a competitively neutral mechanism. These matters are discussed in the remainder of this pleading.

IV. ILECS MUST BE PERMITTED TO REFORM INTERSTATE COST RECOVERY MECHANISMS TO CREATE EFFICIENT PRICING. (*NPRM*, ¶¶ 57-70, 96-112, 247-70)

Critical to access reform is the ability of ILECs to restructure interstate cost recovery mechanisms to eliminate inefficient rate structures and implicit subsidies. To comply with the 1996 Act, minimize inefficiencies, and ensure an internally consistent Commission pricing policy, the Commission must allow ILECs to correct the mismatch between how ILECs incur costs and how such costs are recovered.

In particular, as discussed below regarding common line recovery, the Commission should permit ILECs to recover all interstate-allocated common line costs directly from the end user, unless it determines such direct recovery should be subsidized by other explicit external sources. Any amount of interstate common line cost not recovered directly from end users should be explicitly funded through universal services, as required by the 1996 Act.

As a third-best alternative, the Commission should establish a regulatory policy cost recovery mechanism (separate from access charges) to permit recovery of residual common line costs on a competitively neutral basis. That mechanism should also recover (1) costs that are over- or misallocated to the interstate jurisdiction (including any TIC costs remaining after costs are reassigned to appropriate interstate rate elements); (2) deficiencies resulting from uneconomic depreciation; and (3) the difference between end-office switching rates (after removal of any implicit subsidies) and any Commission-prescribed rates based on hypothetical costs.[46] GTE submits that the recommendations set forth above and described more fully below will correct the pricing anomalies that distort the current access charge regime.

A. The Commission Should Permit ILECs To Recover All Common Line Costs On A Flat Rate And Deaveraged Basis.

There is overwhelming consensus that the Commission should modify its rules governing recovery of the CCL portion of the common line costs. Indeed, "[t]he current CCL charge has been uniformly criticized by both incumbent LECs and IXCs because it discourages efficient use of the network and encourages uneconomic bypass."[47] As the

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[46] Local switching is a special case because the subsidies in the first three categories relate to the loop and transport elements. Upon removal of existing implicit subsidies, pricing of access services can be managed by market forces. Should the Commission decide to price access services at other than market-determined rates, e.g., by setting rates at TELRIC, it will have created a new subsidy that must be fully funded in a competitively neutral manner. As noted above, the availability of below-market rates for unbundled switching creates the same problem by forcing ILECs to reduce their local switching rates to the same level.

[47] *NPRM*, ¶ 58.

Joint Board pointed out in its *Recommended Decision*, "the current, traffic-sensitive CCL charge structure is economically inefficient because the charge requires incumbent LECs to recover a non-usage-sensitive cost in part through a usage-sensitive charge."[48] The Joint Board further observed that "it would be preferable for costs related to the loop to be recovered in a manner that is consistent with the manner in which the costs are incurred."[49] And Chairman Hundt, acknowledging this patent flaw in the CCL rate structure, has stated that the CCL charge "makes high-volume users subsidize lower-volume users."[50] Such hidden universal service support mechanisms are expressly prohibited by the 1996 Act.

The FCC seeks comment on possible revisions to the current CCL charge structure so that ILECs are no longer required to recover the non-traffic sensitive ("NTS") costs of the loop from IXCs on a traffic-sensitive basis. To this end, the Commission asks for comment on the Joint Board's proposal to allow ILECs to recover the costs not recovered from SLCs through a flat, per-line charge paid by IXCs.[51] As a matter of economic efficiency, competitive neutrality and internally consistent Commission policy, the most appropriate way to recover the interstate-allocated costs

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48 *Id.*, ¶ 59; *see also Recommended Decision*, ¶ 775. GTE's 1995 CCL revenues were approximately $699 million.

49 *Id.*

50 "Fifty-Nine Million Consumers Might Be Right," Speech by Reed Hundt, Chairman, Federal Communications Commission, to the National Consumers Week Symposium, Washington, D.C., Oct. 26, 1995, at 3.

51 *See NPRM,* ¶ 60.

of the local loop is to charge the loop cost directly to the party ordering the line, i.e., the end user. Nonetheless, GTE shares the Commission's concern that consumers be protected from price increases that could make local services unaffordable. Therefore GTE proposes below an interstate common line recovery mechanism which furthers a consistent application of Commission policy, while avoiding undesired impacts on consumers, through use of targeted, explicit subsidies.

1. The SLC cap should be eliminated for all customers or subsidized through the universal service mechanism.

In the *NPRM*, the Commission proposes to increase the SLC cap for second and additional lines for residential customers and for all lines for multi-line businesses.[52] In other proceedings the Commission has espoused similar objectives. For instance the Commission's proposal to reduce international accounting rate benchmarks, the Commission has sought to encourage foreign telephone providers to rapidly reduce the cost of terminating international calls by aggressively rebalancing their rate structures.[53]

This consistent application of policy breaks down in the Commission's attempt to differentiate first residential lines and single line business loops from second lines, from

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[52] *Id.*, ¶ 65. The Commission's apparent skepticism of the Joint Board's recommendation to reduce the SLC cap is well warranted. *See id.*, ¶ 64-65. Reducing the cap would violate the 1996 Act's directive of explicit support. Such a reduction also would perpetuate and exacerbate the flow of support from high-volume users to low-volume customers by forcing ILECs to use the CCL rate structure to recoup costs previously recovered through the higher SLC. Under this scenario, ILECs would lose high-volume customers to their competitors that are free to charge flat rates to recover their loop costs. This result is anticompetitive and should not be countenanced.

[53] International Settlement Costs, IB Docket No. 96-261, FCC 96-484 (rel. Dec. 19, 1996).

identical unbundled loops. As the *NPRM* notes, "in the original *Access Charge Order*, the Commission found that recovering NTS costs through flat monthly charges imposed on end users by incumbent LECs would promote optimal utilization of telecommunications facilities."[54] Uncapping the SLC for all residential and business lines is the only way to ensure that implicit subsidies are eradicated.[55]

For example: there simply is no reason for treating the first line ordered by a residence any different from a second line. Both are ordered by the same person. If that person requires no subsidy for the interstate portion of the second loop, then surely no subsidy is required for the first. Similarly in the event a competitor "wins" that same customer and uses both ILEC loops as unbundled elements to provide services to the customer, the ILEC should recover the interstate-allocated costs directly from the competitor. There is no difference between these two loops whether they are classified as common lines or unbundled elements. Any requirements that recovery be structured differently will result in treating carriers asymmetrically.

GTE recognizes that uncapping the SLC could add to the cost recovered on the local telephone bill. This should not make consumers worse off in the aggregate, however. Rather, elimination of the CCL should stimulate offsetting reductions in long distance rates in a competitive interexchange market. Moreover, the alternative

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54 *NPRM,* ¶ 58 (citation omitted).

55 *GTE 96-45 Comments* at 77-83 demonstrate the public policy and administrative reasons for rejecting the Joint Board's recommendation that only primary residence and single-line business lines be eligible for universal service support. Those comments are incorporated into this proceeding by reference.

proposed in the *NPRM* — billing IXCs for the CCL on a flat-rate basis — would not insulate consumers from cost increases. Clearly, the IXCs will simply pass through those charges to their customers, either directly as a surcharge or hidden in higher rates. Indeed, flat-rate billing likely would impose significant harm on consumers distorting competition in the access market. Continued recovery of the CCL by ILECs would incent IXCs to utilize alternative access providers while enabling these competitors to price access above cost. Alternatively, if ILECs sacrificed recovery of part or all of the CCL reserves in order to compete more effectively, they would be hard pressed to continue providing affordable universal service (and would suffer an unconstitutional taking because the FCC would have eliminated the ILECs' ability to recover costs assigned by regulation to the interstate jurisdiction).

If the Commission nonetheless declines to increase the SLC sufficiently to recover all common line costs, ILECs must be able to recover residual common line costs from the universal service fund. Because universal service funding is based on contributions from all telecommunications carriers, recovery through this mechanism is competitively neutral and will not distort consumer choices. Moreover, recovery through universal service funding is appropriate because any reluctance or delay in uncapping the SLC will be founded on affordability concerns. Such recovery would also be consistent with Section 254's mandate that all subsidies be explicit and sufficient. In addition, it would avoid creating disincentives for IXCs to use ILEC-provided access.

Accordingly, recovery of residual CCL costs through the USF is an acceptable, though second-best, means of rationalizing common line cost recovery.[56]

2. The 1996 Telecommunications Act requires that the SLC be geographically deaveraged.

The Commission asks: (1) whether it should permit ILECs to deaverage the SLC, and (2) whether Section 254(e) requires SLC deaveraging.[57] The answer to both questions is yes. The 1996 Act is clear: implicit subsidies are forbidden.[58] Averaging SLC rates over large geographic areas creates undeniable cross-subsidies between high-cost and low-cost areas and between rural and urban areas. To comply with the statute's mandate of explicit support mechanisms, ILECs must therefore be allowed to deaverage SLCs geographically.

The benefits of geographic deaveraging, which have been articulated in other proceedings, are equally applicable in this context. For example, the Commission notes that in the *Price Cap* proceeding, ILECs supported immediate geographic deaveraging of their carrier access charges: "They asserted that costs vary significantly between urban and rural areas," and "argued that the Commission should allow incumbent LECs to begin to deaverage their rates across geographic regions because

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[56] As discussed in Section IV.D., below, if recovery of residual loop costs through universal service funding is not adopted, the Commission must permit ILECs to bill IXCs for such costs on a flat-rate basis through a mechanism separate from access charges.

[57] *See NPRM,* ¶ 67; *see also id.,* ¶ 180.

[58] *See* 47 U.S.C. § 254(e).

non-cost-based, averaged rates cannot be maintained when their markets are open to competition."[59]

The same holds true with respect to the SLC. To compete effectively in the new environment, ILECs must be allowed to deaverage rates immediately. Both the cost and market price of local service can vary widely from one serving area to another.[60] To the extent that the SLC is averaged across all local markets, it will be too low in some areas, and too high in others. The Commission recognizes the competitive distortion created by geographic averaging:

> [D]iscrepancies between price and cost distort competition by creating incentives for entry in low-cost areas by carriers whose cost of providing service is actually higher than the incumbent LEC's cost of serving that area. Similarly, geographic averaging across large geographic areas distorts the operation of markets in high-cost areas when we require incumbent LECs to continue offering services in those areas at prices substantially lower than their costs of providing those services. Prices that are below cost reduce the incentives for entry by firms that could provide the services as efficiently, or more efficiently, than the incumbent LEC.[61]

To ensure rational pricing and encourage the robust competition envisioned by Congress, the Commission should immediately permit ILECs to deaverage the SLC using the same small geographic areas used for universal service high cost support purposes.

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59 *NPRM,* ¶ 181 (citation omitted).

60 Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board, CC Docket No. 80-286, 9 FCC Rcd 7404 (1994).

61 *NPRM,* ¶ 183.

3. Unless the separations treatment of common lines is altered, it is appropriate for ILECs to charge the SLC to purchasers of unbundled loops.

Allowing ILECs to assess the SLC (and the CCL charge to the extent that it continues to exist) on purchasers of unbundled loops is appropriate. The separations practices are rules jointly adopted by the FCC and the states. Those rules guide how ILECs apportion their costs between jurisdictions. The loops used for all local basic exchange services are defined as "common lines," which may be used to place either state or interstate calls. The separations rules require that the NTS costs of common lines be apportioned between the state and interstate jurisdictions on the basis of a gross allocator — currently 25 percent to the interstate jurisdiction. The SLC and CCL are used to recover the portion assigned to the interstate jurisdiction.

The state part (75 percent) is recovered via a pricing system that, taken as a whole, recovers all intrastate costs. State pricing systems have not been and are typically still not designed to recover the specific costs caused by individual users, only total costs in the aggregate. Further, there has never been a correlation between a state price for basic exchange service and a determination of whether or not the interstate common line charges (SLC and CCL) should be applied. For example, if a state sets a price for a PBX trunk at a level that more than recovers the cost of the common line, the Commission's rules still require that the SLC and CCL be charged.

This entire background must be applied to the recovery of costs from common lines that are resold as part of a service package (i.e., resale) or on the basis of piece parts (i.e., unbundled elements). Unless and until the separations treatment of

common lines is altered, the ILEC has no choice but to jurisdictionally allocate its common lines costs in accord with the separations rules. In the federal jurisdiction there are specific rules as to how to charge for recovery of the interstate portion of the common line. Therefore, the assessment of the SLC and CCL charges to all common lines must continue, regardless of the identity of the carrier using the ILEC network to serve end users.

4. ILECs should be given the flexibility to assess the SLC on derived channel services on a per-facility basis.

The FCC seeks comment on the 1996 Act's effect on determining how many SLCs should be applied to ISDN services and whether mandatory rate structures or rate caps should be prescribed for ISDN or other derived channel services.[62] GTE supports a rate structure that applies a single SLC per-facility (or facility equivalent) used to provide a derived channel service.[63] A per-facility charge will encourage the use of ISDN and the deployment of new services.

Notably, the record in related proceedings reveals virtually unanimous opposition to the application of SLCs on a per-derived channel basis.[64] Indeed, in the *End User*

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62 *Id.*, ¶ 70.

63 For example, an ISDN basic rate interface (two B and one D Channels) can be provisioned over a single pair of copper wires (one pair), so one SLC should be applied. An ISDN primary rate interface (23 B and one D channels) is typically provisioned using two copper pairs, thus two SLCs should be assessed.

64 *See NPRM,* ¶ 69 ("All of the commenting parties except AT&T oppose our current rule that assesses a SLC per derived channel. Almost all of the LECs, user groups, equipment manufacturers, IXCs, and other commenters support a rule that would assess a SLC for each pair of copper wires, or a SLC for each ISDN facility.") (citations omitted).

Common Line Charges proceeding, GTE cautioned that the application of SLCs on a per-derived channel basis would cause a huge increase in the price for ISDN services and seriously impede deployment of ISDN, contrary to the Commission's long-standing goal of promoting new services.[65] The Commission itself has found that application of SLCs on a per-derived channel basis "may discourage demand for these services."[66]

ISDN makes it possible to provide greater bandwidth to multi-line customers without a proportional increase in cost. However, uniformly applying one SLC per-derived channel would drive the effective price of ISDN to end users above market levels in many locations. Rather than improving the efficiency of common line cost recovery, as the SLC was intended to do, such an application would introduce a new price distortion that will discourage the use of ISDN.

GTE also urges the FCC not to assess the SLC on derived channel services based on cost ratios between broadband and narrowband facilities.[67] First, calculating cost ratios would be a needlessly complex undertaking. Existing cost studies using jurisdictional separations data are not useful in this context because ISDN loops and equipment are not separately categorized in those data. Consequently, a completely new costing model would have to be developed not only for ISDN, but for all derived channel service applications. The Commission already knows the difficulties

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65 *See* Comments of GTE, End User Common Line Charges, CC Docket No. 95-72 (filed June 29, 1995). ISDN services are also useful in a number of socially beneficial situations such as distance learning, remote health care, and telecommuting.

66 *NPRM,* ¶ 69.

67 *See id.,* ¶ 70.

associated with such an effort from its experience in the interconnection and universal service contexts.

Second, basing SLC application on a cost ratio would result in discriminatory application of SLCs vis-à-vis business customers. If ISDN customers were singled out for a "cost ratio" approach, they would be the only class of customers for whom a cost ratio was used to apply SLCs. If a cost ratio were used for ISDN customers, the majority of business customers would be justified in seeking similar treatment, since business loops generally have a lower per-unit cost than residential loops. To ensure that the public benefits available from ISDN and similar derived channel services are not delayed or diminished, the Commission should allow ILECs to charge SLCs on a per-facility basis for all derived channel services.

B. The Transport Interconnection Charge Should Be Reformed Immediately To Promote Efficient Pricing And Advance Competition.

A second major source of inefficiency and distorted pricing in the current access charge rules is the TIC, which is a hodgepodge of misassignments of costs and implicit subsidies to other access elements and intrastate services. The TIC was created by the FCC as a rate element in the local transport restructure ("LTR") proceeding.[68] The TIC was intended to protect small IXCs from being unduly burdened by 100 percent of the tandem switching costs and also to recover all the costs that could not be specifically

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[68] *See* Transport Rate Structure and Pricing, 7 FCC Rcd 7006 (1992), *recon.*, 8 FCC Rcd 5370 (1993), *further recon.*, 8 FCC Rcd 6233 (1993), *further recon.*, 10 FCC Rcd 3030 (1994) *("LTR Proceeding").*

identified but that remained after the Commission made the transition from the "equal charge per minute-of-use" methodology to the interim methodology adopted in the *LTR Proceeding*. These costs are actual costs that ILECs incur and must have the opportunity to recover.

An analysis of the TIC indicates that some costs need to be reassigned to other interstate rate elements, including 100 percent of tandem switching costs, common channel signaling/signal transfer point costs allocated to tandem switching, host remote links associated with tandem switched transport, and analog end office trunk switch ports. Other costs that are allocated to the interstate jurisdiction using the FCC's separations rules more appropriately belong in the intrastate jurisdiction, such as central office maintenance, central office termination counts, and interexchange cable and wire. The TIC also contains costs that resulted from using high capacity special access rates as the basis for switched access rates. High capacity facilities are mostly found in urban areas and were priced closer to cost because of the competitive nature of this service. Switched transport rates under the "equal charge" methodology reflected an averaging of costs across technologies, geographies, services, and jurisdictions. The transition to the interim LTR with special access as the basis for switched transport rates left a large amount of costs to be recovered somewhere other than switched transport rates to prevent rate shock to small interexchange carriers.

In this proceeding, the Commission's articulated "goal . . . is to establish a mechanism to phase out the TIC in a manner that fosters competition."[69] The

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69 *NPRM*, ¶ 98.

alternatives discussed in the *NPRM* include: (1) allowing ILECs pricing flexibility and permitting market forces to discipline the recovery of the TIC, either alone or in conjunction with a phase-out of the TIC;[70] (2) eliminating the TIC by quantifying and correcting all identifiable cost misallocations;[71] (3) a combination of the above-described approaches;[72] and (4) establishing a schedule under which the costs included in the TIC would be phased out.[73]

The Commission should adopt a modified approach that permits ILECs to: (1) correct all interstate cost misassignments; (2) remove from price caps the costs remaining in the TIC after the interstate misassignments have been corrected; and (3) establish a competitively neutral cost recovery mechanism to recover these costs. First, the FCC should permit ILECs to move the service-related portion of the TIC to the appropriate rate elements and recover those costs through corresponding rates. As more fully described in USTA's comments in this instant proceeding, costs associated with tandem switching, Signaling System 7 ("SS7")/signal transfer point costs allocated to the tandem, host/remote costs, and analog end office trunk port costs should be reallocated to more appropriate rate elements. In addition, tandem-switched transport should be redefined by eliminating the minute-of-use ("MOU") option for serving wire center-to-tandem connections (since this accurately reflects the dedicated nature of this

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70 *Id.*, ¶¶ 113-114.

71 *Id.*, ¶ 116.

72 *Id.*, ¶ 117.

73 *Id.*, ¶ 118.

link), pricing tandem-switched transport to include all multiplexing costs, and permitting ILECs to set rates for tandem-switched transport based on company-specific MOUs as opposed to an arbitrary 9,000 MOUs.[74] Following these cost re-allocations, the FCC should allow ILECs to reprice the affected services to permit full cost recovery.

Second, ILECs should be permitted to recover misallocated costs and other costs allocated to the interstate jurisdiction by the separations process[75] through a competitively neutral mechanism separate from access charges, pending separations reform. Misallocations caused by the Part 36 separations rules include central office termination counts, central office equipment maintenance expense accounts, and interexchange cable and wire investment.

Third, all related costs assigned to the TIC as a result of the transition from the previous "equal charge per minute of use" era to the interim transport structure also must be recovered. As stated previously, these regulatory-policy costs are a result of averaging across technologies, geographical areas, services, and jurisdictions.

Of course, any modifications to Part 36 to reassign to the intrastate jurisdiction costs currently recovered in the TIC would require Federal-State Joint Board action — a process that would undoubtedly take some time. Therefore, until the conclusion of any separations reform, ILECs should be permitted to recover the jurisdictionally

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[74] Nationwide, GTE's average MOUs for a tandem-switched transport trunk is approximately 5,300.

[75] The current access rates are set to recover not only their economic costs, but also allocations to the interstate jurisdiction for embedded joint and common costs, marketing expense, billing inquiry services, local dial switching equipment, 800 database, other billing and collection expenses, and computer expenses.